Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

STUART K. PATRICK,

Petitioner,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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Questions Presented

1. Was Petitioner denied his constitutional right to due process when he was convicted on appeal of a different charge from the one asserted against him by the New York Stock Exchange, after having been unanimously exonerated of that charge in the hearing at the Exchange?

2. Did the Court of Appeals improperly confuse the role of the Securities and Exchange Commission as the appellate reviewer of decisions of the New York Stock Exchange with the SEC's role in connection with disciplinary proceedings conducted by the SEC itself, and thereby undermine and frustrate the appellate review intended by Congress for disciplinary proceedings of self-regulatory bodies such as the Exchange?

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Opinions Below

The Hearing Panel of the New York Stock Exchange, which conducted the trial in this proceeding, rendered an opinion dated April 11, 1991, exonerating Petitioner, which is reproduced in the Appendix at A 28a - 31a. The opinions of the Board of Directors of the Exchange dated March 5 and May 7, 1992, reversing the decision of the Hearing Panel are contained at A 27a and A 22a - 23a. The opinion of the Securities and Exchange Commission dated May 17, 1993, sustaining the sanctions imposed by the Exchange Directors is contained at A 8a - 20a. The opinion of the United States Court of Appeals for the Second Circuit dated January 19, 1994 and

published March 22, 1994, denying Petitioner's petition for a review of the SEC's decision, is contained at A 1a - 7a. Petitioner is not aware of any official reports (to date) of any of those opinions.

Jurisdiction

The judgment of the Court of Appeals was entered on January 19, 1994. There was no petition for re-hearing. This Court has jurisdiction to review the judgment of the Court of Appeals by writ of certiorari pursuant to 28 U.S.C. § 1254(1).

Constitutional and Statutory Provisions Involved

This case involves the Due Process Clause of the Fifth Amendment to the United States Constitution, which provides that "[n]o person shall be . . . deprived of life, liberty or property, without due process of law." This case also involves §§ 19(d)(2) and 25(a)(1) of the Securities Exchange Act of 1934 [15 U.S.C. §§ 78s(d)(2) and 78y(a)(1)], which provide for review by the Securities and Exchange Commission of final disciplinary sanctions imposed by the New York Stock Exchange as a self-regulatory organization [§ 19], and further review by the United States Court of Appeals from final orders of the SEC on such a review [§ 25]. Those statutory provisions are printed in the Appendix at A 39a - 40a, since they are lengthy. Exchange Rules 342(a) and 342(b), which are also applicable to this Petition, are printed at A 38a.

Statement of the Case

the parties

Petitioner, Stuart K. Patrick ["Patrick"] was and is the President of Baird, Patrick & Co., Inc. ["Baird Patrick"], a long-standing, reputable securities broker-dealer which is a mem-

ber of the New York Stock Exchange and is located in New York City.

Baird Patrick, as a registered broker-dealer is subject to the regulatory scheme created by Congress in the Securities Exchange Act, including regulation by the Exchange and the Securities and Exchange Commission.

the Exchange disciplinary charges

Christian Keller, a Vice-President of Baird Patrick, committed certain violations on the floor of the New York Stock Exchange in connection with his trading in a firm proprietary account, for which violations the Exchange disciplined both Mr. Keller and Baird Patrick.

Thereafter, on August 29, 1990, the Exchange's Division of Enforcement issued a Charge Memorandum [A 32a - 34a] against Mr. Patrick, charging that he had violated Exchange Rule 342(a) by failing to "reasonably discharge his duties and obligations in connection with the supervision and control of the activities of an employee or employees under his supervision" [A 34a], viz. Mr. Keller. Specifically, the charge asserted that Mr. Patrick was "a direct supervisor of [Mr. Keller] and was responsible for supervision of Keller's trading" in the firm proprietary account [A 33a, ¶ 11].

In response, Mr. Patrick denied that he had committed any wrongdoing, and specifically that he was Mr. Keller's direct supervisor and was responsible for supervision of Mr. Keller's trading [A 35a - 37a].

the Exchange Hearing Panel decision

On April 11, 1991, a hearing on the charge was held before an Exchange Hearing Panel, at which several witnesses testified and documentary evidence was submitted to the Hearing Panel. The evidence showed that Mr. Patrick, who was located at Baird Patrick's executive offices on Wall Street, several blocks away from the Exchange's trading floor, was

not the supervisor of floor trading for the firm, and was not the supervisor of Mr. Keller's activities on the floor. Indeed, the witnesses at the hearing unanimously so testified, without contradiction by the Exchange's Division of Enforcement.

The Exchange Hearing Panel unanimously exonerated Mr. Patrick of the charge on April 11, 1991 [A 28a - 31a]. The Hearing Panel found that Mr. Patrick was not Mr. Keller's supervisor, and therefore was not guilty of the charge against him under Exchange Rule 342(a), even though the firm (at which he was the President) had failed to implement appropriate supervision of Mr. Keller's floor trading activities.[1] Indeed, the Hearing Panel held that it "cannot find, on the evidence presented in this case, that [Mr. Patrick] in fact had reason to believe he bore direct responsibility over the firm's trader during the relevant period" [A 31a].

the Exchange Directors' decision

The Exchange's Division of Enforcement appealed from the Hearing Panel decision to the Exchange's Board of Directors. A panel of the Directors reversed the Hearing Panel decision on March 5, 1992, and held that Mr. Patrick had violated Exchange Rule 342(a) [A 27a]. As a result, it directed that he be censored and suspended for one week from employment or association in a supervisory capacity with any member firm [*id.*]. Initially, the Directors gave no reasons for its decision [A 27a].

Mr. Patrick duly appealed that decision to the SEC. The SEC, finding the Directors' decision inadequate, directed that the Exchange's Directors supplement their decision [A 25a]; and the Directors did so in a supplementary decision on May

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[1] The firm had relied upon Mr. Keller (as an officer) to supervise floor trading, and thus had failed to establish additional supervision of floor trading. As previously noted, Mr. Keller and the firm (Baird Patrick) were both sanctioned for Mr. Keller's wrongdoing. That lapse by the firm was corrected promptly thereafter.

7, 1992 [A 22a - 23a]. There, the Directors reasoned that Mr. Patrick had violated Rule 342(a) because, as president and chief executive officer of the firm, it was Mr. Patrick's responsibility "to assure that the firm's management structure provided for such supervision" [A 23a].[2] That, however, was not part of the charge against him [cf. A 32a - 34a].

the SEC decision

After briefing to the SEC, the SEC entered an order on May 17, 1993, sustaining the disciplinary action against Mr. Patrick and the sanctions imposed upon him [A 8a - 21a]. The SEC concluded that Mr. Patrick, "as Chief Executive Officer and President of [Baird Patrick], had overall responsibility for the firm's operations" [A 10a] and that, as Mr. Keller's "direct *superior*" [A 11a], Mr. Patrick had violated Exchange Rule 342(a) because he had "failed to assign any responsibility for assuring Keller's compliance with the floor trading rules" [*id.*].[3]

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[2] The Directors also stated that "the evidence established that [Mr. Patrick] exercised supervisory responsibility over certain of the trader's activities" [A 22a]. This apparently referred to testimony that, when Mr. Keller wished to hold securities in the firm's proprietary account overnight, he would discuss that financial question with Mr. Patrick before doing so, so that there would be no adverse impact on the firm's required capital. However, that was not evidence that Mr. Patrick supervised Mr. Keller's *trading* activities on the floor of the Exchange, which were the only activities at issue in the Keller/Baird Patrick disciplinary proceedings and the disciplinary proceeding against Mr. Patrick.

[3] As can be seen from a reading of Exchange Rule 342(a) and Exchange Rule 342(b) [reprinted in the Appendix at A 38a], Rule 342(b), *not* Rule 342(a) requires that a firm's partners or directors "provide for adequate supervisory control" and designate "a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control". Rule 342(b) also requires that the designated person "establish a separate system of follow-up and review" to assure that employees are adequately supervised. Mr. Patrick contended, and contends here, that he has been found guilty on appeal of violating Rule 342(a) on the basis of responsibilities under Rule 342(b)—a rule and responsibilities which he was never charged with having violated.

the Court of Appeals decision

On July 13, 1993, Mr. Patrick petitioned the United States Court of Appeals for the Second Circuit, seeking a reversal of the SEC's order and reinstatement of the Exchange Hearing Panel's decision exonerating him. The Court of Appeals had jurisdiction to hear and decide that petition pursuant to § 25(a)(1) of the Securities Exchange Act [15 U.S.C. § 78y(a)(1)], which allows a person "aggrieved by an order of the SEC to obtain a review thereof in the United States Court of Appeals for the circuit in which he resides or has his principal place of business"; Mr. Patrick's principal place of business is within the Second Circuit.[4]

On January 19, 1994, the Court of Appeals denied Mr. Patrick's petition and sustained the SEC's order sanctioning Mr. Patrick [A 1a - 7a]. The Court of Appeals held that, since "as president, Patrick was 'in charge' of all the employees in the firm", he was necessarily responsible for supervision of Mr. Keller's activities unless he had himself delegated that function to someone else or knew that someone else was performing that function [A 6a]. In doing so, the Court of Appeals cited and relied upon two decisions of the SEC involving disciplinary proceedings brought by the SEC itself, not proceedings under Exchange Rule 342(a) or otherwise brought by the Exchange's Division of Enforcement.[5] Mr. Patrick is now petitioning this Court for a writ of certiorari with respect to that decision.

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[4] On his application, the penalties imposed against Mr. Patrick have been stayed pending his appeals.

[5] Moreover, the only cases with respect to Exchange Rule 342 cited on behalf of the Division of Enforcement referred to consent decrees, not contested proceedings where this issue was ever actively litigated.

Reasons for Granting the Petition

1. The issues are important

This case presents important constitutional and statutory questions. These include: [a] the right of a person to obtain a fair and meaningful review of a disciplinary action by a self-regulatory securities exchange; [b] the appropriate role of the SEC (as the oversight agency specified by Congress for such review) and, thereafter, by the Courts of Appeals (which Congress specified as the reviewing authority for such decisions of the SEC); and [c] the responsibility and potential liability of the president of a corporation merely because he holds that office (a matter governed by state law, but legislated by the SEC's decision here).

Review by this Court is necessary not only to correct a serious injustice, but also to assure that Congress's intention in creating a system of appellate review is not rendered nugatory; i.e., to delineate the appropriate appellate responsibilities of the SEC and the Courts of Appeals when reviewing disciplinary proceedings of self-regulatory organizations. These matters are also important because the decisions below set an important precedent, and have serious societal and economic implications with respect to civil disciplinary proceedings in general, and for the highly-regulated securities industry and the legitimate expectations and responsibilities of corporate officers.[6]

2. Petitioner's right to due process was plainly violated

After having been exonerated of the only charge made against him, Mr. Patrick was found guilty on appeal of committing wrongdoing which was never charged against him and is not specified in the only Exchange Rule cited in the Charge Memorandum against him (i.e., Rule 342(a)). Mr. Patrick con-

[6] Indeed, the SEC itself, in convincing the Court of Appeals to publish its opinion, emphasized the precedential nature and effect of the decision at issue [A 41a - 43a].

tends (and contended before the SEC and the Court of Appeals) that his constitutional right to due process prohibits his being convicted on appeal of a charge which was never made against him below and which he was never required to defend himself against at his trial (i.e., the Exchange hearing). See, e.g., *U.S.* v. *Baker*, 807 F.2d 1315, 1323-24 (6th Cir. 1986).

On the appeal to the SEC, the SEC broadened the charge to refer to Mr. Patrick's role as Mr. Keller's direct *superior* (as opposed to supervisor); and it blended or legislated responsibilities provided for in Rule 342(b) into Rule 342(a) [see, e.g., A 13a - 15a]. As Mr. Patrick showed, when the Exchange intends to charge an individual with violating both Exchange Rule 342(a) and Exchange Rule 342(b), it had so specified in its Charge Memorandum, mentioning both such rules and delineating the allegedly wrongful conduct under both such rules. That was not done here.

Even if the Court agrees with the SEC and the Court of Appeals that Mr. Patrick's supposed responsibilities as a corporate "superior" are implicit in Exchange Rule 342(a), a proposition with which Petitioner respectfully disagrees, that does not alter the impropriety of the procedure applied against Mr. Patrick, since the Charge Memorandum was limited to Mr. Patrick's supposed role as Mr. Keller's direct *supervisor* (*not superior*) and the supposed supervisor's role with respect to Mr. Keller's trading activities on the Exchange floor. Mr. Patrick successfully defended himself against that charge at the hearing.[7] Mr. Patrick was not called upon to defend himself against the charge first raised on the appeal from the Hearing Panel Decision, i.e. that his position as pres-

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[7] The Hearing Panel's findings in this regard are entitled to special deference on appeal, since it was the Hearing Panel, not the appellate bodies, which heard the witnesses (including Messrs. Patrick and Keller, the two persons directly involved), observed their demeanor, and otherwise had the duty of weighing the evidence as it was presented. See, e.g., *Anderson* v. *Bessemer City*, 470 U.S. 564, 573-75 (1985).

ident of the firm and vis-a-vis Mr. Keller in the corporate structure imposed other and different duties with respect to the supervision of Mr. Keller (viz., a supposed duty to assure that Mr. Keller had some supervision). That, Petitioner respectfully submits, is a responsibility under Exchange Rule 342(b), not Exchange Rule 342(a); however, regardless of that fact, it was improper to confront Mr. Patrick with such a new charge on appeal, after the trial was over.

If left standing, the decision below will mean that persons charged with violation of a specific Exchange rule (in a disciplinary proceeding before a self-regulatory organization such as the Exchange) will always risk conviction on appeal—after prevailing at the hearing on the specific charge—on the basis of new matters, arguments, responsibilities and even rules not included in the charge, which they were called upon to defend at the hearing. That, we respectfully submit, violates the most basic requirements of the Due Process Clause of the Fifth Amendment, and indeed the concept of basic fairness which underlies our judicial system.

3. The Court of Appeal's decision undermines Congress' intent

When Congress created the appellate structure for review of disciplinary decisions of self-regulatory organizations such as the Exchange (as prescribed in the Securities Exchange Act), it necessarily intended that such appellate review would be meaningful and fair, in accordance with the Fifth Amendment of the United States Constitution. We respectfully submit that the decisions below undermine and frustrate Congress's intent in that regard.

First, by allowing an appellate reviewing authority to change the grounds for a supposed conviction and depart from the Charge Memorandum, the decisions below deprive an individual of his right to a fair trial of the charge against him. The contention that the supposed responsibilities which the

Court of Appeals held Mr. Patrick violated are implicit in Rule 342(a) is not a sufficient justification for the appellate reviewers' departure from the specific and limited Charge Memorandum which Mr. Patrick was called upon to defend himself against at the hearing. The Charge Memorandum did not charge Mr. Patrick with violating Rule 342(a) on the basis of those other supposed duties. By contrast, the Exchange Hearing Panel correctly addressed itself to the specific charge against Mr. Patrick. Thus, the Hearing Panel rendered the appropriate decision with respect to the Charge Memorandum, which stated the *only* charge that Mr. Patrick defended himself against, and was called upon to defend himself against.

Second, the Court of Appeals confused the role of the SEC as a reviewing body with its separate and different role as a disciplinary body. Here, the SEC is called upon solely to review the disciplinary decision of the Exchange. The SEC itself had not brought any disciplinary action against Mr. Patrick, and its disciplinary procedures and the precedents with respect to its own disciplinary proceeding were not at issue. The SEC ignored its appellate responsibility and, instead, legislated into Exchange Rule 342(a) its view of what that Rule *should* provide (i.e., the supposed responsibility of a corporate "superior"), which is not contained in that rule. That was improper; it conflicted with the role which Congress gave to the SEC in this situation; and it further deprived Mr. Patrick of his constitutional right to due process.

The Court of Appeals compounded this error by relying upon two decisions of the SEC which have nothing to do with Exchange Rule 342(a), but rather disciplinary actions by the SEC's own enforcement branch. Those decisions are not appropriate interpretations of Exchange Rule 342(a). Had the SEC's enforcement authorities brought proceedings against Mr. Patrick, he would have defended himself against the standards set forth in those decisions; however, that never happened. The only body which asserted a charge against Mr. Patrick was the Exchange, and it did so on the limited

grounds specified in the Charge Memorandum, with specific reference to Rule 342(a) and only that rule. It was improper for the SEC, particularly as appellate reviewing authority, to go beyond that rule and act as prosecutor (e.g., by, in effect, re-writing the charge against Mr. Patrick). It was also improper for the Court of Appeals to justify the SEC's decision by reference to such authorities, as opposed to authorities under or with respect to Exchange Rule 342(a).

Conclusion

For the foregoing reasons, the Petition for a writ of certiorari should be granted.

Dated: April 19, 1994
New York, New York

Respectfully submitted,

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 866—August Term, 1993

(Argued: January 13, 1994 Decided: January 19, 1994)
Published: March 22, 1994

Docket No. 93-4148

STUART K. PATRICK,

Petitioner,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Before:

MINER and MAHONEY, *Circuit Judges*
and RESTANI,* *Judge*.

Petition for review of an order of the Securities and Exchange Commission sustaining sanctions imposed on

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* Honorable Jane A. Restani of the United States Court of International Trade, sitting by designation.

petitioner by the New York Stock Exchange, the SEC having found that petitioner, the president of a broker-dealer, failed to discharge his duty to supervise his firm's trader.

Petition denied.

MARTIN I. KAMINSKY, New York, NY (W. Hans Kobelt, Pollack & Kaminsky, New York, NY, of counsel), *for petitioner.*

KATHARINE B. GRESHAM, Assistant General Counsel, Securities and Exchange Commission, Washington, DC (Jacob H. Stillman, Associate General Counsel, William F. Johnson, Attorney, Securities and Exchange Commission, Washington, DC, of counsel), *for respondent.*

PER CURIAM:

I.

Petitioner Stuart K. Patrick petitions this Court for review of a May 17, 1993 order of the Securities and Exchange Commission ("SEC") sustaining sanctions imposed on him by the New York Stock Exchange (the "Exchange"), the SEC having found that Patrick, the president of a broker-dealer, failed to discharge his duty to supervise his firm's trader. For the reasons that follow, we affirm the order of the SEC.*

* Our decision on this appeal originally appeared in an unpublished summary order. The SEC subsequently moved to have the decision published. Because we agree with the SEC that this decision will have some precedential value, we have decided to publish it with some minor revisions.

At all relevant times, Patrick was the President and CEO of Baird, Patrick & Co., a broker-dealer and a member firm of the Exchange. Christian Keller was a vice president in charge of trading for the firm on the floor of the Exchange. Under the firm's organizational structure, Keller reported only to Patrick, or, in his absence, to Patrick's father, the chairman of the board. Between January and June of 1988, Keller initiated numerous trades on the floor of the Exchange for Baird, Patrick's proprietary account that violated Exchange rules designed to prevent members from gaining an advantage over brokerage customers when trading on their own accounts.

In August of 1990, the Exchange's Division of Enforcement charged Patrick with violating New York Stock Exchange Rule 342(a)* by failing to discharge his duties and obligations reasonably in connection with the supervision and control of Keller's trading activities. In an April 11, 1991 decision, rendered after a hearing, an Exchange hearing panel (the "Panel") exonerated Patrick from liability under Rule 342(a). In its decision, the Panel found that Baird, Patrick "did not have clear lines of responsibility for its officers," and that, as a result, Keller went unsupervised during the six-month period in question. The Panel went on to state that Patrick, as president and CEO, "did not take sufficient general authority to assure that the Firm's management structure provided for such supervision," and that "it appears that [Patrick] believed he had no day-to-day role in the Firm's operations; he seems to have assumed that the Treasurer of the Firm bore primary responsibility in that area. This was too

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* Rule 342(a) provides, in pertinent part:

The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations.

lax a view of managerial responsibility." Patrick does not dispute these findings. Despite its view of the facts, the Panel concluded that Patrick "cannot be held to the specific failure to supervise that was the subject of this hearing."

The Division of Enforcement sought review of the Panel's decision with the Exchange's Board of Directors (the "Board"). The Board reversed the decision of the Panel, censured Patrick and suspended him for one week from employment with Exchange members. In its decision, which was supplemented at the request of the SEC, the Board concluded that the Panel had "applied the wrong standard to the facts in the evidentiary record" and that there was ample evidence in the record to support a finding that Patrick violated Rule 342(a).

Patrick sought review by the SEC of the Board's determination. In a May 17, 1993 opinion and order, the SEC upheld the Board's determination. The SEC stated that, as Keller's direct superior, Patrick maintained supervisory responsibilities over Keller. The SEC noted that Rule 342(a) not only imposes obligations on direct supervisors, but also imposes "oversight duties on officials, including the president, who are in charge of employees and activities within the firm." The SEC rejected Patrick's contention that he had discharged his duty by delegating responsibility to Keller, a senior officer. The SEC reasoned that Patrick had a duty to follow up on any delegation of duties, which he failed to do. The SEC next rejected Patrick's contention that he had been denied due process because the Board had implicitly held him liable under Rule 342(b), which imposes an obligation on directors and partners to provide for appropriate supervisory control within their organization to ensure compliance with the securities

laws.* The SEC reasoned that Patrick's duties under Rule 342(a) included the duty to establish proper procedures and that the mere fact that a more specific rule applied did not make the general rule inapplicable. The SEC also reasoned that Patrick's liability flowed primarily from his failure to exercise his duties as Keller's immediate superior, duties which fall squarely within Rule 342(a). On July 13, 1993, Patrick petitioned this Court for review of the SEC's order.

II.

Patrick's main contention in his petition for review is that his conduct in this case, if it is actionable at all, falls within the provisions of Rule 342(b) rather than Rule 342(a), and that he was denied due process when he was sanctioned without having been charged under Rule 342(b). We are in agreement with the SEC that Patrick's conduct with regard to Keller violated Rule 342(a), and Patrick accordingly was not deprived of due process. A plain reading of these sections reveals that 342(b) obligates a firm to set up a chain of command to ensure supervision, follow-up and review of employee activities.

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* Rule 342(b) provides:

> The general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall:
>
> (1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control.
>
> (2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.

Within a chain of command, each individual will of course be responsible for those who serve under him, and Rule 342(a) imposes an obligation upon such individuals to supervise the activity of those of whom he is "in charge." For high-level officers, this supervisory role naturally includes overseeing the supervision of other individuals down the chain of command. Patrick's argument that Rule 342(a) only applies to direct supervisors is simply inaccurate; as president, Patrick was "in charge" of all the employees in the firm. Indeed, the SEC has held that the president of a broker-dealer " 'is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient.' " *In re Kochcapital, Inc.*, Sec. Exch. Act Rel. No. 31652 (Dec. 23, 1992), 53 SEC Docket 205, 210 n.18 (quoting *In re Universal Heritage Invs. Corp.*, 47 S.E.C. 839, 845 (1982)).

Patrick does not dispute the fact that he had overall responsibility for the firm's affairs, and it appears from the record that Keller reported directly to Patrick on a limited aspect of Baird, Patrick's proprietary account. Moreover, Patrick does not deny that there was nobody else to whom Keller reported. While the firm had a responsibility under Rule 342(b) to provide for an adequate command structure, it was Patrick's duty under 342(a) to oversee the implementation of that structure. By completely failing to provide for supervision of Keller's trading, both the firm and Patrick failed in their responsibilities. In addition, as Keller's direct corporate superior, Patrick had a duty either to supervise him directly or to oversee his supervision by others. Patrick adamantly asserts that he did not directly supervise Keller's trading.

But he also did not ensure that others did supervise Keller. By failing to delegate Keller's supervision to someone else, Patrick himself became responsible for the supervision. The Panel concluded that Patrick believed that Jack Glynn, the firm's treasurer, was responsible for monitoring Keller's trading. Even if this is so, the complete lack of supervision of Keller indicates that Patrick did not exercise the necessary oversight.

From the foregoing, it is clear that Patrick properly was held responsible for violating Rule 342(a). Patrick's argument that a president cannot be held liable for the actions of his employees on the trading floor is without merit. Patrick cites to cases in which the president of the firm was not held responsible for wrongdoing on the trading floor. In each of these cases, however, the president simply was not charged; neither case holds that the president was not responsible for the wrongdoing. *See In re Shearson Lehman Bros., Inc.*, Exch. Hearing Panel Dec. 90-48 (NYSE May 7, 1990); *In re Prudential-Bache Secs., Inc.*, Exch. Hearing Panel Dec. 90-121 (NYSE Sept. 6, 1990).

III.

The petition for review of the order of the Securities and Exchange Commission is denied.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Rel. No.32314 / May 17, 1993

Admin. Proc. File No. 3-7715

In the Matter of the Application of

STUART K. PATRICK
New York, New York

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

OPINION OF THE COMMISSION

NATIONAL SECURITIES EXCHANGE—REVIEW OF DISCIPLINARY PROCEEDINGS

Violation of Exchange Rule

Failure to Supervise

Where chief executive officer and president of member firm of national securities exchange failed to exercise reasonable supervision over vice-president with a view to preventing his trading violations, *held*, exchange's findings of violation and the sanctions it imposed *sustained*.

APPEARANCES:

Martin I. Kaminsky and *W. Hans Kobelt*, of Pollack & Kaminsky, for Stuart K. Patrick.

Richard J. Sheehan, *Simon Swidler*, *Richard Simonelli*, and *Allen D. Boyer*, for the New York Stock Exchange, Inc.

Appeal filed: April 14, 1992

Briefing completed: September 25, 1992

I.

Stuart K. Patrick, chief executive officer and president of Baird Patrick & Co., Inc. ("BPC"), a member of the New York Stock Exchange, Inc. ("NYSE" or "Exchange"), seeks review of NYSE disciplinary action. The NYSE found that Patrick failed reasonably to supervise and control the activities of an employee under his supervision.[1] The NYSE censured Patrick and suspended him for one week from employment or association in any supervisory capacity with any member or member organization. Our findings are based on an independent review of the record.

II.

This case involves Patrick's supervision of trading in BPC's proprietary account on the floor of the Exchange from January through June 1988.[2] The activities that prompted the NYSE's action were violations committed by BPC's floor trader, Christian G. Keller, during that period.[3] Keller violated various restrictions on proprietary trading under the Securities Exchange Act of 1934 and NYSE Rules.[4] The purpose of these restrictions is, among other things, to allow any member in the crowd with a public order to claim precedence in

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[1] Exchange Rule 342(a) provides that each office, department or business activity of a member or member organization shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility. The rule requires that the person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations.

[2] Patrick entered the securities industry in 1969. He became the firm's president in 1975 or 1976 and its chief executive officer in 1986.

[3] Keller became a member of the Exchange in 1967. He became BPC's Exchange floor broker in 1978.

[4] The trading violated Section 11(a)(1) of the Exchange Act, Rule 11a-1 thereunder, and NYSE Rule 111(a).

execution over orders for the accounts of members or persons associated with members. The restrictions limit the ability of Exchange members to effect trades on the Exchange floor in an account in which the member has an interest,[5] require floor brokers to be properly registered to initiate proprietary trades on the Exchange floor,[6] and require that transactions on the Exchange floor for a firm's proprietary account be announced to the crowd.[7]

Patrick, as chief executive officer and president of BPC, had overall responsibility for the firm's operations.[8] Also, in specific areas, he engaged in daily supervisory activity. These areas included customer accounts and corporate bond trading.

During the first six months of 1988, Keller was a vice president of the firm. There were only five firm officers at that time.[9] Keller reported only to Patrick or, if Patrick was unavailable, to Patrick's father, the chairman of the board. Keller was the firm's NYSE floor trader and was in charge of the firm's floor operations. In fact, he was the firm's only employee on the floor. He shared equally with BPC the profits or losses in the firm's floor proprietary trading account, and did all the trading for the account.

The pertinent floor trading rules were promulgated a number of years before the relevant period. At that time, Patrick and the firm's treasurer reviewed those rules with Keller to ensure that he understood them. For about three to six months thereafter, the treasurer monitored Keller's trading to ensure that Keller complied with the rules. Once Patrick and the treasurer were satisfied with Keller's performance, responsibility for compliance with the rules was delegated to Keller himself. Thereafter, Patrick's dealings with Keller were lim-

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5 *See* Section 11(a)(1) of the Exchange Act and Rule 11a-1 thereunder.

6 *See* NYSE Rule 111.

7 *See* Exchange Act Rule 11a1-1(T)(a).

8 He acknowledged this fact before the NYSE.

9 In addition to Patrick and Keller, the other firm officers were the chairman of the board, another vice-president, and the treasurer.

ited to deciding whether Keller could carry a position overnight in the firm's proprietary trading account.

NYSE investigators discovered that, during the relevant six month period, Keller initiated on the Exchange floor over 1500 trades that violated the proprietary trading rules. These violations included Keller's initiation of trades on the exchange floor without prior communication with the firm's order room, without marking the orders to denote that they were proprietary trades,[10] and without notifying the crowd that the trades were for the firm's proprietary account.[11]

III.

Exchange Rule 342(a) requires that the person in charge of certain employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees. The NYSE found that Patrick failed to supervise Keller as required by that rule. We agree.

During the relevant period, the firm had no management structure by which Keller was to be supervised, and Patrick, as Keller's direct superior, conducted no supervision. Before the NYSE, Patrick readily stated that "the buck stopped with [Keller]." In all, Patrick failed to address the fact that, as Keller's direct superior, he retained supervisory responsibilities over Keller. As a result, Keller received no supervision whatsoever.

In particular, Patrick failed to assign any responsibility for assuring Keller's compliance with the floor trading rules. Keller himself did not have any clear idea what was done at

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[10] *See* NYSE Rule 410(b).

[11] Pursuant to offers of settlement, the Exchange sanctioned Keller and the firm for these violations. Keller was censured and suspended for two months from membership, allied membership, approved person status, and employment or association in any capacity with a member or member organization. *Christian G. Keller*, Exchange Hearing Panel Decision 90-161 (November 2, 1990). The firm was censured and fined $20,000. *Baird Patrick & Co., Inc.*, Exchange Hearing Panel Decision 90-160 (November 2, 1990).

the firm's office to review his trading. In fact, apparently nothing was done in that respect.[12]

Patrick argues that supervisory accountability in this case rests solely with the firm. We do not agree. A firm can act only through individuals. As Keller's direct superior, Patrick had the individual responsibility for assuring that supervision of Keller was adequate.[13] This he failed to do.

Patrick also contends that he fulfilled his responsibility for the floor trading at issue when he delegated responsibility for supervising those activities to Keller, a senior firm officer. That argument likewise fails. Supervision, by its very nature, cannot be performed by the employee himself.

Moreover, it is not sufficient for the person with overarching supervisory responsibilities to delegate supervisory responsibility to a subordinate, even a capable one, and then simply wash his hands of the matter until a problem is brought to his attention. The supervisory responsibilities imposed upon Patrick by Rule 342(a) consist not merely of a duty to delegate supervisory authority to qualified individuals. Implicit is the additional duty to follow-up and review that delegated authority to ensure that it is being properly exercised.[14] The NYSE's requirement tracks our own announced views. As we stated in *Mabon. Nugent & Co.*:

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[12] Patrick notes that the firm's treasurer and its back office manager had responsibilities with respect to, among other areas, the back office and the order room. Indeed, Patrick could have directed these officials to aid in the monitoring of certain aspects of Keller's activities. However, he did not do so.

[13] *See Kochcapital, Inc.*, Securities Exchange Act Release No. 31652 (December 23, 1992), 53 SEC Docket 361, 370.

[14] The existence of the duty to follow-up under Rule 342(a) is reflected in the more detailed provisions governing supervision systems in Exchange Rule 342(b). That section expressly provides that the officer with overall supervisory authority is required to establish a separate *system* of follow-up and review to determine that any delegated authority is being properly exercised. The inter-relationship between Rule 342(a), which Patrick was charged with violating, and Rule 342(b) will be discussed below in Section IV.

> Apart from adopting effective procedures broker-dealers must provide effective staffing, sufficient resources and a system of follow up and review to determine that any responsibility to supervise delegated to compliance officers, branch managers and other personnel is being diligently exercised.[15]

Patrick failed to follow-up personally and to review the duties he had delegated to Keller to determine that those duties were being diligently performed. Instead, he allowed Keller to function autonomously. As we have indicated, no process of delegation can be taken to that extreme.[16]

In light of the above considerations, we find, as did the NYSE, that Patrick failed reasonably to supervise and control the activities of Keller, an employee under his supervision, in violation of Exchange Rule 342(a).[17]

IV.

Patrick claims that in various respects he was denied due process. He asserts that the charge against him was improperly changed when the decision of the Exchange Hearing Panel was appealed to the NYSE's Board.[18] He notes that he

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[15] Securities Exchange Act Release No. 27301 (September 27, 1989), 44 SEC Docket 1348, 1349.

[16] *See SECO Securities, Inc.*, Securities Exchange Act Release No. 26054 (September 1, 1988), 41 SEC Docket 1204, 1207.

The focus of the NYSE's case against Patrick, and hence of our findings, has been on the particular rule violations that occurred in the wake of the failure of supervision described above. We should note, however, that, in the supervisory vacuum that Patrick created, more serious problems could have arisen.

[17] Patrick contends that the language of Rule 342(a) gives rise to supervisory duties with respect only to activities, but not to individuals. This point has no merit.

[18] The Exchange Hearing Panel unanimously found Patrick not guilty of the charge of deficient supervision brought against him. On review, the NYSE Board of Directors reversed the Hearing Panel's determination and found Patrick guilty of that violation.

was charged with violating part (a) of Rule 342. According to Patrick, it was only part (b) of that rule (a provision the NYSE has never cited against him) which could form the basis for the Board's finding against him.[19] Patrick argues that he was found to have committed failures as president, not as a direct supervisor, to establish within the firm adequate "lines of responsibility" and supervisory structure. In his view, such claims are chargeable only under Rule 342(b).

These contentions lack merit. Rule 342(a) includes the general requirement that responsible officials properly supervise employees under their authority. Violations of that requirement may stem from various causes, including, but not limited to, a failure to establish proper procedures, impose suitable intermediate structures, or draw upon the assistance of other firm personnel. Where such failures are contributing factors, it is not necessary to cite a rule that specifically addresses them.[20] Nor does the fact that such a specific rule exists make the more general rule inapplicable.

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[19] Exchange Rule 342(b) provides that the general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person is required to: (1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control; and (2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility are being properly exercised.

[20] Our decisions under Section 15(b)(6) of the Exchange Act, which incorporates Section 15(b)(4)(E) by reference, reflect a similar approach. The statute provides that the Commission may sanction any person associated with a broker-dealer if we find that such person "failed reasonably to supervise, with a view to preventing [securities] violations . . . another person who commits such a violation, if such other person is subject to his supervision." Although this statutory language does not specifically so provide, we have used this language to reach failures to establish proper procedures. *See William E. Parodi Sr.*, Securities Exchange Act Release No. 27299 (September 27, 1989), 44 SEC Docket 1337; *Gary W. Chambers*, Securities Exchange Act Release No. 27963 (April 30, 1990), 46 SEC Docket 200. The *Parodi* and *Chambers* orders

This reasoning applies here. Beyond his failure to establish systems or procedures, Patrick failed to afford Keller supervision. As proscribed by Rule 342(a), he did not "reasonably discharge his duties and obligations in connection with supervision and control of the activities of [an employee] related to the business of [his] employer and compliance with securities laws and regulations." Hence the NYSE properly charged and found a violation of that rule.[21]

Patrick's proposed distinction between the duties of a president and the duties of a direct supervisor does not aid him. The requirements of Rule 342(a) include not only the duties of direct supervisors, but the oversight duties of officials, including the president, who are in charge of employees and activities within the firm.

In any event, Patrick's duties regarding Keller did not flow primarily from the fact that Patrick occupied the office of president. Keller stood immediately below Patrick in the chain of command. Thus, in this case, Patrick's supervisory duties as the firm's president and as Keller's direct superior converged. These duties clearly are embraced by the broad provisions of Rule 342(a).

Patrick had adequate notice and an adequate opportunity to defend himself in these respects. Contrary to Patrick's view, the NYSE did not unfairly change the theory of its case. As set forth in the complaint, the NYSE's charges stated not only that Patrick was Keller's direct supervisor but also that he failed to take effective steps to prevent violative trading.[22]

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were issued pursuant to settlements with the respondents. Those orders properly state the Commission's opinion on this issue.

[21] In their brief filed before us, the Exchange's counsel emphasize what they describe as the NYSE's findings of a failure by Patrick to provide for "supervisory systems." However, the theory embraced by the NYSE's decision was not limited to that failure. Rather, the decision pointed to an overall failure to provide actual supervision. The decision cited, along with failures regarding management systems or structures, the fact that Keller received no supervision whatsoever and Patrick's failure to exercise "day-to-day" supervisory responsibility.

[22] Even if, after the filing of the complaint, the Exchange had reformulated its theory of violation—which was not the case—we would

Patrick further argues that a member of the Board panel that heard oral argument on his case had a serious conflict of interest. He explains that Board panel member David Shields is the brother of former BPC employee Joseph Shields; that Joseph Shields has had less than friendly relations with the firm; and that Joseph and David Shields work together at Shields & Co. Patrick states that David Shields continually interrupted his counsel's presentation to the panel.

Patrick must be considered to have waived any objection he may have had to David Shields' participation. He was aware of David Shields' presence on the panel at the time of the Board's February 6, 1992 hearing.[23] Patrick had ample time to raise this issue before the NYSE. He could have done so during the month between the hearing and the Board's March 5 decision, or prior to the Board's May 27, 1992 supplemental decision. Instead, Patrick first raised the point in his July 16, 1992 brief on appeal to the Commission.

As one court has explained, it is inappropriate for a party to "suppress his misgivings while waiting anxiously to see whether the decision goes in his favor."[24] We expressed a sim-

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not conclude that Patrick suffered prejudice. *See RFG Options Co.*, Securities Exchange Act Release No. 26114 (Sept. 26, 1988), 41 SEC Docket 1473. The Exchange's Division of Enforcement, in its opening statement before the Hearing Panel, specifically stated that it would show that Patrick failed in his overall supervisory capacity as chief executive officer as well as in his direct supervision in important areas related to the case. Counsel for Patrick was aware of the nature of the charge after the Division's opening statement before the Hearing Panel. Indeed, as counsel later acknowledged, he presented evidence to rebut the Exchange's theory. Also, he neither objected nor sought a continuance. Moreover, the essential facts underlying this case appear to be undisputed. Under all the circumstances, we find no unfair lack of notice regarding the Exchange's theory of the case, and are unable to discern any impropriety in connection with the presentation of the charges against Patrick.

[23] In his brief on appeal to the Commission, Patrick merely states that he "later learned" of the relationship between Joseph and David Shields. He does not define "later."

[24] *Marcus v. Director*, 548 F.2d 1044, 1051 (D.C. Cir. 1976) (when charge of bias or prejudice is raised late in proceedings, claimant's good faith is put in doubt and time and effort are wasted). The Court stated:

(*footnote continued*)

ilar view when we stated generally that "a respondent cannot be permitted to gamble on one course of action and, upon an unfavorable decision, to try another course of action."[25]

Moreover, the Exchange's counsel have raised serious factual questions in rebuttal to Patrick's claims. Counsel state that Joseph Shields' employment with BPC ended more than 20 years ago, and that BPC's own notice of termination shows that Joseph Shields resigned voluntarily, with no wrongdoing alleged. Because the objection was not raised below, the record does not establish that the problem was any more serious than as now described by the NYSE. Even now, Patrick, in his reply brief, merely asserts that the Exchange's effort to explain away David Shields' participation on the appeal panel "is inaccurate and, of course, proffers matter outside the record."

In all, Patrick has not shown that David Shields' participation rose to the level of actual unfairness.[26] The claims of bias are purely speculative, and nothing in the record shows prejudice on the part of David Shields or the other Board members. To the contrary, David Shields, as well as the other Board members, merely asked relevant questions of Patrick's counsel, which did not impede counsel's presentation to the Board. Accordingly, we find no impropriety in the conduct of

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> It is especially important . . . that a charge of bias or prejudice be raised at once, whenever a party concludes in good faith that the decision-maker should be disqualified from hearing the case. If the issue of bias is raised in a timely fashion, permitting more prompt attention to the matter, each party's rights to a fair and impartial tribunal are better protected. *Id.* at 1050 (footnote omitted).

[25] *David T. Fleischman*, 43 S.E.C. 518, 522 (1967), quoted with approval in *Gross v. SEC*, 418 F.2d 103, 108 (2d Cir. 1969).

[26] *Cf. Cal Caulfield and Company, Inc.*, 48 S.E.C. 452, 455-456 (1986) (claimed disqualification of National Association of Securities Dealers District Committee vice-chairman, who reviewed hearing panel recommendations and joined in Committee's decision): "[A]pplicants' vague assertion that the vice-chairman and [the individual respondent] 'were not on friendly terms' is insufficient to warrant the vice-chairman's disqualification."

the Board's hearing.[27] As discussed above, ample grounds existed for the Board's decision against Patrick.[28]

Patrick argues that his investigative testimony was incompletely transcribed because there was a subsequent discussion with the Exchange staff that was not transcribed. He contends that the Division misused parts of the transcribed testimony by using remarks that were later clarified in the untranscribed discussion.[29] He maintains that the Division declined to call the interviewer as a witness, and had the interviewer exit the hearing room before Patrick could call him.

Patrick was not treated unfairly. The hearing officer stated that the interviewer would be available if Patrick needed to call him. Instead, Patrick, in his testimony before the Hearing Panel, presented his version of his investigative testimony and the subsequent discussion that was not transcribed. Patrick's counsel then stated that the point he would have made by calling the interviewer had been made by Patrick. The defense then rested without requesting that the interviewer be summoned. Under these circumstances, Patrick has no cause for complaint.[30]

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[27] We note that Patrick's counsel made no objection to any line of questioning or interruptions by David Shields or other Board members at the time.

[28] Furthermore, any prejudice of this kind would be cured by our independent review of the record. *See Charles L. Campbell*, 42 SEC Docket 1391, 1396 n. 13, Securities Exchange Act Release No. 26510 (February 1, 1989); *Howard D. Gatliff*, 47 S.E.C. 252, 254-255 n. 11 (1980).

[29] Patrick asserts that the Division misused his investigative testimony by insisting that he admitted that he had "overall supervisory responsibility for the account in which Keller was trading" and "direct responsibility for supervising the firm's order room." Patrick contends that in the untranscribed discussion he explained, among other things, that he was not Keller's "supervisor."

[30] Patrick also complains that moments prior to the start of the hearing the Division handed his counsel a 111-page document purporting to show over 1500 illegal trades effected by Keller. He asserts that he had no prior opportunity to review the exhibit. Patrick argues that this was an unfair attempt by the Division to tar him with alleged wrongdoing unrelated to him and to deprive him of a fair opportunity to defend himself.

(footnote continued)

There is no substance to Patrick's further contention that, during the investigation of Keller, Patrick was told that he was not the target of any inquiry. Patrick did not substantiate this claim, nor was there a reasonable basis for assuming that the instant proceedings would not be instituted. In any event, Patrick has not cited any specific inadequacies in the record resulting from any such assumption.[31]

Internal compliance is the first line of defense against trading abuses. In that regard, Patrick did not meet the supervisory responsibilities incumbent upon him. We find the sanctions neither excessive nor oppressive.

Patrick argues that it is unconscionable to sanction him when no comparable officer of any other firm was even charged in other Exchange proceedings involving violations similar to Keller's. However, appropriate remedial action depends on the facts and circumstances of each particular case, and cannot be precisely determined by comparison with the actions taken in other cases.[32] Patrick has failed to demonstrate selective prosecution,[33] or systemic disparities in sanctioning as between particular industry segments.[34]

These contentions have no merit. Patrick has never disputed Keller's trading violations. Thus Patrick has not shown that he suffered any prejudice from the asserted fact that he did not receive a copy of the exhibit until shortly before the hearing. Moreover, Patrick did not raise this point when he appeared before the Board.

[31] *See Richard J. Buck & Co.*, 43 S.E.C. 998, 1011 (1968).

[32] *See Butz v. Glover Livestock Commission Co.*, 411 U.S. 182, 187 (1973); *Hiller v. SEC*, 429 F.2d 856, 858-859 (2d Cir. 1970).

[33] To demonstrate selective prosecution, Patrick must establish that he was singled out for enforcement action while others who were similarly situated were not and that his prosecution was motivated by arbitrary or unjust considerations, such as race, religion, or the desire to prevent the exercise of a constitutionally-protected right. *See United States v. Huff*, 959 F.2d 731, 735 (8th Cir.), *cert. denied*, 113 S. Ct. 162 (1992); *C.E. Carlson, Inc. v. SEC*, 859 F.2d 1429, 1437 (10th Cir. 1988); *Baltimore Gas & Elec. Co. v. Heintz*, 760 F.2d 1408, 1419 (4th Cir.), *cert. denied*, 474 U.S. 847 (1985).

[34] *See Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1112 (D.C. Cir.), *cert. denied*, 488 U.S. 869 (1988).

An appropriate order will issue.[35]

By the Commission (Acting Chairman SCHAPIRO and Commissioners ROBERTS and BEESE).

/s/ JONATHAN G. KATZ
Jonathan G. Katz
Secretary

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[35] All of the contentions advanced by the parties have been considered. They are rejected or sustained to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No.32314 / May 17, 1993

Admin. Proc. File No. 3-7715

In the Matter of the Application of

STUART K. PATRICK
New York, New York

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

ORDER SUSTAINING DISCIPLINARY ACTION TAKEN BY NATIONAL SECURITIES EXCHANGE

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken by the New York Stock Exchange, Inc. against Stuart K. Patrick be, and it hereby is, sustained, and that the sanctions imposed be, and they hereby are, sustained.

By the Commission.

/s/ JONATHAN G. KATZ
Jonathan G. Katz
Secretary

NEW YORK STOCK EXCHANGE INC.

Appeal from Exchange Hearing Panel
Decision 91-51

In the Matter of

STUART K. PATRICK
(Published as "X)

The Board supplements its decision dated March 5, 1992 as follows:

The Board reverses the determination of the Hearing Panel in its Decision 91-51. Accordingly, the Board finds Stuart K. Patrick guilty of the charge that he:

> Violated Exchange Rule 342(a) in that he failed to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of an employee or employees under his supervision.

Contrary to the conclusion reached by the Hearing Panel in this matter, the Board found ample evidence in the record to support a finding that Stuart K. Patrick violated Exchange Rule 342(a). The Hearing Panel found that the Firm "did not have clear lines of responsibility for its officers" and that Patrick's belief and assumption that he had no day-to-day role with respect to supervisory responsibilities as chief executive officer and president, reflected "too lax a view of managerial responsibility". Notwithstanding Patrick's assumption, the evidence established that he exercised supervisory responsibility over certain of the trader's activities. The Board finds that the lines of responsibility for the Firm's officers were unclear and finds that this is unacceptable practice under Exchange rules. Furthermore, the Hearing Panel found that:

1) "the trader received no supervision whatever" during the relevant period; 2) the Firm had no management structure by which the trader was to be supervised; and 3) Patrick did not exercise his authority as president and chief executive officer "to assure that the Firm's management structure provided for such supervision". Notwithstanding these findings, the Hearing Panel erroneously concluded that Patrick was not guilty of failure reasonably to supervise simply because he believed that as president and chief executive officer, he did not have a day-to-day role in that regard and because he assumed another officer was supervising the conduct underlying the violation.

Consequently, the Board found that the Hearing Panel applied the wrong standard to the facts in the evidentiary record and, reversed the Hearing Panel decision and determined that the following penalty be imposed:

> Stuart K. Patrick shall be censured and suspended for a period of one week from employment or association in any supervisory capacity with any member or member organization.

The Board believes this penalty is appropriate in view of the seriousness of the violation and the specific facts and circumstances of this case.

May 7, 1992

By the Board of Directors
New York Stock Exchange, Inc.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION
April 24, 1992

Administrative Proceeding File No. 3-7715

In the Matter of the Application of

STUART K. PATRICK
New York, New York

For Review of Disciplinary Action Taken by the

NEW YORK STOCK EXCHANGE, INC.

ORDER GRANTING STAY AND DIRECTING SUPPLEMENTATION OF RECORD

Stuart K. Patrick, a member of the New York Stock Exchange, Inc. ("NYSE") and chief executive officer and president of Baird, Patrick & Co. Inc., a NYSE member firm, seeks a stay, pending Commission review, of NYSE disciplinary action. The NYSE found that, in 1988, Patrick failed reasonably to discharge his duties and obligations in connection with the supervision and control of the activities of a trader under his supervision. The NYSE censured Patrick and suspended him for one week from employment or association in any supervisory capacity with any member or member organization. The suspension is scheduled to commence at the close of business on April 24, 1992.

The NYSE has not opposed Patrick's stay request. Consistent with standard practice in considering requests for stays of

censures and suspensions, it appears appropriate to stay the sanctions assessed here. The NYSE suspended Patrick for a limited time. Were Patrick to serve his suspension before his appeal were decided, he could lose the benefit of a favorable outcome. A stay of the censure is likewise warranted.

We further note the need to rectify a deficiency in the record of this proceeding. The NYSE Hearing Panel unanimously found Patrick not guilty of the charge of deficient supervision brought against him. However, on review, the NYSE Board of Directors (the "Board") reversed the Hearing Panel's determination, found Patrick guilty of that violation and imposed the aforementioned sanctions. The Board's decision, however, failed to provide the grounds for its reversal of the Hearing Panel decision. In particular, it did not explain its finding of misconduct or provide any justification for the sanctions it assessed. We shall accordingly direct the Board to supplement the record herein by providing an explanation for its determination and for any sanction it may seek to impose.

Accordingly, IT IS ORDERED that the request of Stuart K. Patrick for a stay of the disciplinary action taken against him by the New York Stock Exchange, Inc. be, and it hereby is, granted;

IT IS FURTHER ORDERED that the Board of Directors of the New York Stock Exchange be, and it hereby is, directed to supplement the record herein in accordance with this order within 30 days after serviced of this order; and

IT IS FURTHER ORDERED that the New York Stock Exchange shall, within 10 days after having supplemented the record in the manner prescribed above, certify and file with this Commission, pursuant to Rule 19d-3(b) under the Securities Exchange Act, one copy of the record upon which the disciplinary action at issue was taken, together with seven copies of an index to such record.

By the Commission.

/s/ JONATHAN G. KATZ
Jonathan G. Katz
Secretary

NEW YORK STOCK EXCHANGE INC.

Appeal from Exchange Hearing Panel
Decision 91-51

In the Matter of

STUART K. PATRICK
(Published as "X)

The Board reverses the determination of the Hearing Panel in its Decision 91-51. Accordingly, the Board finds Stuart K. Patrick guilty of the charge that he:

> Violated Exchange Rule 342(a) in that he failed to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of an employee or employees under his supervision.

The Board determines that the following penalty shall be imposed:

> Stuart K. Patrick shall be censured and suspended for a period of one week from employment or association in any supervisory capacity with any member or member organization.

March 5, 1992

By the Board of Directors
New York Stock Exchange, Inc.

NEW YORK STOCK EX[illegible]ANGE, INC.

X, AN ALLIED MEMBER OF THE EXCHANGE, WAS CHARGED WITH HAVING VIOLATED EXCHANGE RULE 342(A) IN THAT HE FAILED TO REASONABLY DISCHARGE HIS DUTIES AND OBLIGATIONS IN CONNECTION WITH THE SUPERVISION AND CONTROL OF THE ACTIVITIES OF AN EMPLOYEE OR EMPLOYEES UNDER HIS SUPERVISION—NOT GUILTY.

EXCHANGE HEARING PANEL DECISION 91-51

April 11, 1991

An Exchange Hearing Panel conducted a hearing on charges brought by the Exchange's Division of Enforcement against X, an allied member of the Exchange. X was charged with having violated Exchange Rule 342(a) in that he failed to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of an employee or employees under his supervision.

X submitted an Answer in which he admitted some facts as alleged in the Memorandum of Charges and denied others. He denied the charge.

Specifically, while admitting that an officer of his firm consented to a penalty for floor trading violations, X contended that as chief executive officer and president of his firm, he could not reasonably be expected to supervise all departments and persons at the firm. He asserted that he necessarily had to delegate direct supervisory functions to others at the firm, and could not reasonably be charged with direct responsibility for supervising another officer of the firm who was located outside the firm's executive offices, and who had long experience and a previously umblemished record. X also contended that there was no further purpose to penalizing him after the responsible employee and the firm itself had already consented to penalties. After a hearing, at which X appeared with counsel, and testified, the Exchange Hearing Panel found that:

1. X was born in 1939 and entered the securities industry as a partner of a member firm (the "Firm") in 1969. He became president of the Firm in 1975 and chief executive officer in 1986. He is still employed in these capacities.

2. On or about June 20, 1988, the Firm was notified of an inquiry by the Market Surveillance Division of the Exchange concerning trades entered by the Firm.

3. In 1978, the Firm employed a trader who has been a member of the Exchange since 1967 and who is currently a vice president of the Firm.

4. From 1978 and continuing to the present, the trader and the Firm jointly maintained the Firm's proprietary account (the "Account"). The trader shared in 50% of the profit and losses of this Account.

5. Prior to November 1989, the trader was not registered with the Exchange as a competitive trader nor was he approved by the Exchange to so act.

6. During the period from at least January 2, 1988 to on or about June 30, 1988 (the "relevant period"), the trading described herein was not subject to any of the exceptions from registration set forth in Exchange Rule 111(a).

7. During the relevant period, the trading described herein was not subject to any of the exceptions set forth in Section 11(a)(1) of the Securities Exchange Act of 1934 and Regulation 240.11 a-1 promulgated thereunder.

8. During the relevant period and for the majority of his proprietary trading for the Account, the trader

failed to announce to the crowd that he was entering proprietary trades for the account.

9. During the relevant period, the trader initiated a series of purchases and sales for the Account in Exchange listed stocks, on the Floor, on an average of at least four times a day (four purchases and four sales): 1) without prior receipt of orders from the Firm's order room, 2) without marking the orders to denote they were proprietary ("G") trades, or 3) notifying the crowd that said trades were for the Firm's proprietary account.

10. The trading set forth above violated Section 11(a)(1) of the 1934 Act and SEC Reg. 240.11a-1 thereunder and Exchange Rule 111(a).

11. During the relevant period, the Firm had no management structure by which the trader was to be supervised, and, apparently, the trader received no supervision whatever.

12. X, while believing he had general supervisory authority, took no day-to-day role in operations or in directly supervising the order room. He left that to the Treasurer of the Firm and other officials. His only contacts with the trader were occasional ones in which he would discuss with the trader any overnight positions taken in the account and related matters.

DISCUSSION

X was president and chief executive officer of a Firm which did not have clear lines of responsibility for its officers. Consequently, no one supervised the Firm's trader during a six-month period when the trader continuously violated trad-

ing rules of the Exchange and the SEC. As president and chief executive officer, it appears that X did not take sufficient general authority to assure that the Firm's management structure provided for such supervision.

However, the Panel cannot find, on the evidence presented in this case, that X in fact had reason to believe he bore direct responsibility over the Firm's trader during the relevant period. Rather, it appears that X believed he had no day-to-day role in the Firm's operations; he seems to have assumed that the Treasurer of the Firm bore primary responsibility in that area. This was too lax a view of managerial responsibility, for which the Firm and its trader have been penalized. Nevertheless, X cannot be held to the specific failure to supervise that was the subject of this hearing.

DECISION

The Hearing Panel, by unanimous vote, found X not guilty of the charge against him.

For the Hearing Panel

/s/ MILTON M. STEIN
Milton M. Stein
Hearing Officer

NEW YORK STOCK EXCHANGE, INC.

DIVISION OF ENFORCEMENT

MEMORANDUM

SUBJECT: CHARGE AGAINST STUART K. PATRICK, CHIEF EXECUTIVE OFFICER AND PRESIDENT OF BAIRD, PATRICK & CO., INC.

STATEMENT OF FACTS AND EXPLANATION

Background and Jurisdiction
Stuart Patrick

1. Stuart K. Patrick was born on May 1, 1939 and entered the securities industry as a partner of Baird Patrick & Co., Inc. (the "Firm") in 1969. He became president of the Firm in 1975 and chief executive officer in 1986. He is still employed in these capacities.

2. On or about June 20, 1988, the Firm was notified of an inquiry by the Market Surveillance Division of the Exchange concerning trades entered by the Firm.

Christian Keller

3. In 1978, Christian Keller became employed as a floor broker with Baird, Patrick & Co., Inc. (the "Firm"). Keller has been a member of the Exchange since 1967 and he is currently a vice president of the Firm.

Non-Registered and Competitive Trading and
Failure to Disclose Trading in a Proprietary Account

4. From 1978 and continuing to the present, Keller and the Firm jointly maintained the Firm's proprietary account (the "Account"). Keller shared in 50% of the profit and losses of this Account.

5. Prior to November 1989, Keller was not registered with the Exchange as a competitive trader nor was he approved by the Exchange to so act.

6. During the period from at least January 2, 1988 to on or about June 30, 1988 (the "relevant period"), the trading described herein was not subject to any of the exceptions from registration set forth in Exchange Rule 111(a).

7. During the relevant period, the trading described herein was not subject to any of the exceptions set forth in Section 11(a)(1) of the Securities Exchange Act of 1934 and Regulation 240.11 a-1 promulgated thereunder.

8. During the relevant period and for the majority of his proprietary trading for the Account, Keller failed to announce to the crowd that he was entering proprietary trades for the account.

9. During the relevant period, Keller initiated a series of purchases and sales for the Account in Exchange listed stocks, on the Floor, on an average of at least four times a day (four purchases and four sales): 1) without prior receipt of orders from the Firm's order room, 2) without marking the orders to denote they were proprietary ("G") trades, or 3) notifying the crowd that said trades were for the Firm's proprietary account.

10. The trading set forth above violated Section 11(a)(1) of the 1934 Act and SEC Reg. 240.11a-1 thereunder and Exchange Rule 111(a).

11. From 1978 to the present, Patrick was the direct supervisor of Keller and was responsible for supervision of Keller's trading in the Account.

12. During a time encompassing the relevant period, Patrick was responsible for supervising the order room.

13. Patrick failed to detect that Keller was initiating trades in the Account from the trading floor.

14. Patrick failed to take effective steps to prevent improper proprietary trading in the Account.

CHARGE

Stuart K. Patrick, by reason of the facts set forth in the Statement of Facts and Explanation, violated Exchange Rule 342(a) in that he failed to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of an employee or employees under his supervision and is, therefore, subject to discipline pursuant to Exchange Rule 476(a).

August 29, 1990
Date

By RICHARD J. SHEEHAN
Richard J. Sheehan
Vice President

Simon Swidler
Enforcement Director

Richard Simonelli
Principal Enforcement
Investigator

NEW YORK STOCK EXCHANGE

Matter of

STUART K. PATRICK

Answer

Respondent Stuart K. Patrick ("SKP") answers the charge against him, as President and CEO of Baird Patrick & Co., Inc. ("BP&Co"), as follows:

1. SKP admits the allegations in paragraphs 1 through 4.

2. SKP admits, on information and belief (specifically the Statement of Facts and Consent to Penalty signed by Christian Keller) the allegations in paragraphs 5, 8, 9.

3. SKP declines to respond to paragraphs 6, 7 and 10, since they aver matters of law and SKP is a layman; but SKP acknowledges that, in other proceedings, Mr. Keller has admitted these allegations.

4. SKP denies the allegations in paragraphs 11 through 14, except admits that he was senior to Mr. Keller at BP&Co, and that he knew Keller was BP&Co's floor representative and was initiating trades in the Account during the period at issue.

5. SKP denies any wrongdoing as alleged in the Charge.

6. SKP further points out, by way of affirmative defense(s), that:

(a) Mr. Keller was (and is) an officer of BP&Co, which then had only 5 officers. In that capacity, he was the senior BP&Co person invoived in trading on the floor and for the Account. SKP's office was (and is) located at the firm's executive offices, which occupy an entire floor at 63 Wall Street (in addition to branch offices).

As CEO and President, SKP had a broad range of responsibilities at and for BP&Co. He could not possibly directly supervise all departments and persons at the firm, and cannot reasonably be expected to have done so. Like the CEO's of all brokerage firms of any significant size, SKP had to (and was entitled to) delegate certain functions, including direct supervisory functions, to others at the firm; and SKP had a right to rely on the firm's other officers to perform their duties appropriately. Like the CEO's of other multi-faceted firms, SKP cannot reasonably be charged with direct responsibility for everything done by every employee in every department of the firm—particularly, the conduct of another officer located outside of the firm's executive offices who had a long and demonstrated record of experience and proper conduct. Mr. Keller had 20 years of experience on the Exchange floor and an unblemished record.

When the "G trade rules" were promulgated, SKP and John J. Glynn, BP&Co's Treasurer met with Mr. Keller and were assured that he understood the rules. Thereafter, in a further exercise of diligence and caution, Mr. Glynn monitored Mr. Keller's trading on a day-to-day basis for at least six months, to assure that it complied with the rules; it did. At that point, the firm (and SKP) reasonably concluded that Mr. Keller was conversant with and was complying with the rules. This conclusion was further justified and corroborated by Mr. Keller's long unblemished record on the Exchange floor and in general.

(b) Mr. Keller and BP&Co have already consented to censures and other penalties (a two month suspension for Mr. Keller and $20,000 fine for BP&Co) for the alleged wrongdoing at issue here. SKP was not personally involved in that aspect of the business. It would be unjustified, and will serve no useful purpose, to punish SKP personally for the same matters.

(c) The alleged wrongdoing (on information and belief) was commonplace on the floor of the Exchange during the

time at issue. Many brokers were doing the same thing, as a matter of convenience (not venality); and the market surveillance arm of the Exchange was not policing or demanding strict compliance with the G trading rules. Given the Exchange's tacit consent to the conduct at issue and its own laxity, it is particularly inappropriate and anomalous for the Exchange to seek to punish a firm's CEO, who had no direct role in or responsibility for that conduct.

Wherefore, Respondent SKP respectfully submits that the charge against him is baseless and unwarranted, and requests that it be dismissed.

Dated: September 24, 1990
New York, New York

Pollack & Kaminsky
Attorneys for Respondent
Stuart K. Patrick
61 Broadway (Suite 2500)
New York, New York 10006
(212) 952-0330

Offices—Approval, Supervision and Control

Rule 342. (a) Each office, department or business activity of a member or member organization (including foreign incorporated branch offices) shall be under the supervision and control of the member or member organization establishing it and of the personnel delegated such authority and responsibility.

The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations.

(b) The general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities' laws and regulations. This person shall:

(1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control.

(2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.

§ 78s. Registration, responsibilities, and oversight of self-regulatory organizations

(d)(1) If any self-regulatory organization imposes any final disciplinary sanction on any member thereof or participant therein, denies membership or participation to any applicant, or prohibits or limits any person in respect to access to services offered by such organization or member thereof or if any self-regulatory organization (other than a registered clearing agency) imposes any final disciplinary sanction on any person associated with a member or bars any person from becoming associated with a member, the self-regulatory organization shall promptly file notice thereof with the appropriate regulatory agency for the self-regulatory organization and (if other than the appropriate regulatory agency for the self-regulatory organization) the appropriate regulatory agency for such member, participant, applicant, or other person. The notice shall be in such form and contain such information as the appropriate regulatory agency for the self-regulatory organization, by rule, may prescribe as necessary or appropriate in furtherance of the purposes of this chapter.

(2) Any action with respect to which a self-regulatory organization is required by paragraph (1) of this subsection to file notice shall be subject to review by the appropriate regulatory agency for such member, participant, applicant, or other person, on its own motion, or upon application by any person aggrieved thereby filed within thirty days after the date such notice was filed with such appropriate regulatory agency and received by such aggrieved person, or within such longer period as such appropriate regulatory agency may determine. Application to such appropriate regulatory agency for review, or the institution of review by such appropriate regulatory agency on its own motion, shall not operate as a stay of such action unless such appropriate regulatory agency otherwise orders, summarily or after notice and opportunity for hearing on the question of a stay (which hearing may con-

sist solely of the submission of affidavits or presentation of oral arguments). Each appropriate regulatory agency shall establish for appropriate cases an expedited procedure for consideration and determination of the question of a stay.

§ 78y. Court review of orders and rules

(a)(1) A person aggrieved by a final order of the Commission entered pursuant to this chapter may obtain review of the order in the United States Court of Appeals for the circuit in which he resides or has his principal place of business, or for the District of Columbia Circuit, by filing in such court, within sixty days after the entry of the order, a written petition requesting that the order be modified or set aside in whole or in part.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

93-4148

STUART K. PATRICK,

Petitioner,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

Each motion must be accompanied
by a supporting affidavit.

NOTICE OF MOTION
for Publication of Decision

MOTION BY:

Paul Gonson, Solicitor
Securities and Exchange Commission
450 5th Street, NW—Mail Stop 6–6
Washington, DC 20549
(202) 272-2471

Has consent of opposing counsel:

A. been sought?	☐ Yes	☒ No
A. been obtained?	☐ Yes	☒ No
Has service been effected?	☒ Yes	☐ No
Is oral argument desired?	☐ Yes	☒ No

(*Substantive motions only*)

Requested return date:
(*See Second Circuit Rule 27(b)*)

Has argument date of appeal been set:

A. by scheduling order?	☒ Yes	☐ No
B. by firm date of argument notice?	☒ Yes	☐ No
C. If Yes, enter date	1/13/94	

Judge or agency whose order is being appealed:
Securities and Exchange Commission

Brief statement of the relief requested:
Publication of the decision issued on January 19, 1994.

OPPOSING COUNSEL:

Martin I. Kaminsky
Pollack & Kaminsky
114 West 47th Street, Suite 1900
New York, New York 10036

Previous requests for similar relief and disposition:

None

Statement of the issue(s) presented by this motion:

Whether the decision in this matter should be published in the Federal Reporter?

Brief statement of facts (*with page references to the moving papers*):

In its January 19, 1994 decision in this case, the Court directed that its order not be published in the Federal Reporter or cited or relied upon in other cases (Memorandum at 1). This decision is the first judicial decision of which we are aware that discusses in detail supervisory responsibilities of officials in brokerage firms (*id.*).

Summary of the argument (*with page references to the moving papers*):

Because the decision in this case establishes significant judicial authority on supervisory responsibilities in securities firms, it would be of undoubted usefulness to the securities industry, the bar, and the courts. Publication in the Federal Reporter would permit its use in other cases in this important area of securities regulation (Memorandum at 1-2).

By /s/ [PAUL GONSON]
Signed name must be printed beneath
Paul Gonson

Appearing for: (*Name of party*)

Securities and Exchange Commission
Respondent

2/8/94

Supreme Court, U S
FILED
JUN 30 1994
OFFICE OF THE CLERK

No. 93-1651

In the Supreme Court of the United States

OCTOBER TERM, 1993

STUART K. PATRICK, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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QUESTION PRESENTED

Whether the Securities and Exchange Commission properly determined that a brokerage firm's president failed to discharge his supervisory duties reasonably when he neglected either to supervise or to delegate the responsibility for supervising a vice president who was conducting improper trades for the firm.

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In the Supreme Court of the United States

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STUART K. PATRICK, PETITIONER

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BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-7a) is reported at 19 F.3d 66. The decision of the Securities and Exchange Commission (Pet. App. 8a-20a, 21a) is not yet reported.

JURISDICTION

The judgment of the court of appeals was entered on January 19, 1994. The petition for a writ of certiorari was filed on April 19, 1994. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Petitioner Stuart K. Patrick is the president and chief executive officer of Baird, Patrick & Co., Inc. (Baird, Patrick), a member of the New York Stock Exchange, Inc. (Exchange). Pet. App. 2a-3a. He contends that the court of appeals erred in affirming an order of the Securities and Exchange Commission that sustained disciplinary action taken against him by the Exchange based on a finding that he failed to exercise reasonable supervision over the securities trading activities of an employee, in violation of New York Stock Exchange Rule 342(a) (*reprinted at* Pet. App. 38a).[1] Pet. App. 5a.

1. a. As a national securities exchange registered with the Commission, the New York Stock Exchange is responsible for regulating its members and persons associated with its members. The Exchange is subject to comprehensive oversight by the Commission in performing those responsibilities. See 15 U.S.C. 78f(b) and 78s. Under Section 19(d)(2) and (e)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(d)(2) and (e)(1), disciplinary action taken by the Exchange is subject to review by the Commission. On review, the Commission considers the record *de novo* and makes its own findings as to whether the conduct in question violated the Exchange's rules. See 15 U.S.C. 78s(e)(1). The Commission's findings and order are then subject to judicial review. See 15 U.S.C. 78y(a); *R.H. Johnson & Co.* v. *SEC*,

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[1] Rule 342(a) provides, in relevant part:

> The person in charge of a group of employees shall reasonably discharge his duties and obligations in connection with supervision and control of the activities of those employees related to the business of their employer and compliance with securities laws and regulations.

198 F.2d 690, 694-695 (2d Cir.), cert. denied, 344 U.S. 855 (1952).

b. At the time of the events that led to petitioner's disciplinary proceeding, Christian G. Keller was a vice president of Baird, Patrick and the head of trading for that firm on the floor of the Exchange. Keller was also in charge of trading in Baird, Patrick's proprietary account. Under the firm's organizational structure, Keller reported only to petitioner or, in petitioner's absence, to the chairman of the board. Petitioner acknowledged that, as president and chief executive officer, he had overall supervisory responsibility for the firm's operations, and that he and the chairman were the persons at the firm who were responsible for internal supervision and control and for compliance with the securities laws. Pet. App. 3a, 9a-10a.

Between January and June 1988, Keller initiated more than 1,500 trades on the floor of the Exchange for Baird, Patrick's proprietary account in violation of rules designed to prevent Exchange members, when trading for their own accounts, from gaining an unfair advantage over brokerage customers.[2] Apart from a brief period when the proprietary account trading rules were first adopted in 1978, no one at Baird, Patrick monitored Keller's trading to ensure that he complied with the rules. In testimony before the Exchange, petitioner repeatedly emphasized that neither he nor anyone else at

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[2] Those rules implement 15 U.S.C. 78k(a)(1), which restricts the ability of an exchange member to effect trades on the exchange floor in an account in which the member has an interest. That Section is designed to allow any member on an exchange floor with a public order to claim precedence in execution over orders for the accounts of members or persons associated with members. See 15 U.S.C. 78k(a)(1); 17 C.F.R. 240.11a-1.

the firm supervised Keller. Pet. App. 10a-11a; C.A. App. 95.

2. a. The Exchange's Division of Enforcement charged petitioner with violating Exchange Rule 342(a) by failing to discharge his duties and obligations reasonably in connection with the supervision and control of Keller's trading activities. Pet. App. 32a-34a. An Exchange hearing panel found that petitioner was not responsible for the failure to supervise Keller. *Id.* at 28a-31a. On review, however, the Exchange's Board of Directors reversed the panel's determination and found that petitioner had violated Rule 342(a). The Board of Directors censured petitioner and suspended him for a period of one week from employment or association in any supervisory capacity with any Exchange member or member organization. Pet. App. 22a-23a, 27a.

b. Petitioner applied to the Commission for review of the Board's decision. Based on an independent review of the record, the Commission sustained the disciplinary action imposed by the Exchange. Pet. App. 8a-21a. The Commission stated that "the firm had no management structure by which Keller was to be supervised, and [petitioner], as Keller's direct superior, conducted no supervision." *Id.* at 11a. The Commission held that, as Keller's direct superior, petitioner was responsible for ensuring that he received adequate supervision, but that petitioner failed to supervise Keller himself or to delegate responsibility for Keller's supervision. *Id.* at 11a-13a.

The Commission also rejected petitioner's assertion that he was denied due process because he was found to have violated Rule 342(a) by failing, as the firm's president, to establish adequate procedures and structures for Keller's supervision. Petitioner argued that such conduct could only be charged under clause (b) of

Rule 342.[3] The Commission concluded, however, that clause (a) of Rule 342 encompasses "not only the duties of direct supervisors, but the oversight duties of officials, including the president, who are in charge of employees and activities within the firm." Pet. App. 15a. The Commission reasoned that Rule 342(a) includes the general requirement that such officials properly supervise employees under their authority, and that a violation of Rule 342(a) can result from a variety of causes, including a failure by the officials to establish proper supervisory procedures and structures. Pet. App. 14a.

c. The court of appeals denied petitioner's petition for review. Pet. App. 1a-7a. The court agreed with the Commission that petitioner's conduct violated Rule 342(a) and that petitioner was not denied due process. Pet. App. 5a. The court concluded that Rule 342(a) imposes an obligation on each person in a firm's chain of command to supervise the activities of those employees that person oversees. Pet. App. 6a. Rejecting peti-

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[3] Rule 342(b) (*reprinted at* Pet. App. 38a), provides:

The general partners or directors of each member organization shall provide for appropriate supervisory control and shall designate a general partner or principal executive officer to assume overall authority and responsibility for internal supervision and control of the organization and compliance with securities laws and regulations. This person shall:

(1) delegate to qualified principals or employees responsibility and authority for supervision and control of each office, department or business activity, and provide for appropriate procedures of supervision and control.

(2) establish a separate system of follow-up and review to determine that the delegated authority and responsibility is being properly exercised.

tioner's contention that Rule 342(a) applies only to direct supervisors, the court pointed out that petitioner, as president, was in charge of all the firm's activities and employees. Pet. App. 6a. The court found that petitioner's failure as president to oversee the implementation of an adequate command structure that provided for Keller's supervision violated Rule 342(a). Pet. App. 6a. In addition, the court found that petitioner, as Keller's direct corporate superior, failed to satisfy his duty under Rule 342(a) to supervise Keller directly or to oversee his supervision by others. Pet. App. 6a.

ARGUMENT

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Petitioner errs in contending (Pet. 8-9) that Rule 342(a) did not impose an obligation on him to supervise Keller because petitioner had not been designated as Keller's supervisor. The court of appeals properly determined that petitioner, as Keller's direct corporate superior, violated Rule 342(a) by failing to discharge his responsibility for supervision of Keller's trading activities. Petitioner was in charge of Keller, a vice president immediately below petitioner in the chain of command. Petitioner concedes that he did not supervise Keller's activity or delegate that responsibility to anyone else at the firm. That conduct violated Rule 342(a)'s requirement that a person in charge of employees must reasonably discharge his or her supervisory responsibilities over those employees.

2. Contrary to petitioner's contention (Pet. 9), petitioner was not improperly found liable under Rule 342(a) for conduct that could be charged only under Rule

342(b). The fact that a failure to supervise under Rule 342(a) results from a failure to establish appropriate procedures for supervision, which might itself amount to a violation of Rule 342(b), does not remove the conduct from the ambit of Rule 342(a).[4] Moreover, petitioner's violation of Rule 342(a) was not based primarily on his failure to establish supervisory procedures for the firm's employees; rather, the primary basis of his liability was his failure, as Keller's direct superior, to supervise him or to delegate that responsibility. Pet. App. 15a.

3. Petitioner's claim (Pet. 7) that his due process rights were violated because he was found liable for wrongdoing that was never included in the charge against him is without merit. Petitioner was not, as he asserts, charged by the Exchange solely as Keller's designated supervisor. Petitioner's wrongdoing as Keller's direct corporate superior was included in the Exchange's charge and was addressed at the hearing. The Exchange's charge showed the corporate chain of command by identifying petitioner as president and Keller as vice president, stated that petitioner "was

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[4] It is not unusual for the same conduct to violate more than one statute or rule. See, *e.g.*, *SEC* v. *National Securities, Inc.*, 393 U.S. 453, 468 (1969). Further, contrary to petitioner's assertion (Pet. 8), Exchange hearing panel decisions often describe Rule 342(a) violations as based on the failure of a brokerage firm president to provide appropriate procedures or systems of supervision, and they often make no reference to Rule 342(b). See, *e.g.*, *Arthur Howard Ross*, Exchange Hearing Panel Dec. No. 87-13 (Mar. 10, 1987), 1987 WL 225759 (NYSE) (FSEC-ALL Database). Where violations of both Rule 342(a) and Rule 342(b) are charged, the description of each violation frequently includes similar language with respect to a failure to assure adequate systems and procedures of supervision. See, *e.g.*, *Joseph A. Vitanza*, Exchange Hearing Panel Dec. No. 92-26 (Feb. 14, 1992), 1992 WL 300598 (NYSE) (FSEC-ALL Database).

responsible for supervision of Keller's trading in the [proprietary] Account," and alleged that petitioner "failed to take effective steps to prevent improper proprietary trading in the Account." Pet. App. 32a-33a. Thus, the Commission did not, as petitioner contends (Pet. 8), broaden the charge against him when it found him liable based on his responsibility as Keller's direct superior.

In addition, petitioner's wrongdoing as Keller's direct superior was addressed at the panel hearing. The testimony before the panel showed that petitioner was Keller's direct superior and that he nonetheless did not supervise Keller's activity or delegate that responsibility to anyone else at the firm. C.A. App. 2, 4, 62, 66, 86-87, 95. Even if petitioner did not have adequate notice that the charge encompassed his failure to supervise Keller as direct superior, any additional evidence that he might have adduced regarding Keller's supervision would have contradicted petitioner's own steadfast position that "nobody supervises Mr. Keller other than Mr. Keller."[5] *Id.* at 95.

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[5] Petitioner also argues that the charge did not encompass his failure, as the firm's president, to establish procedures and structures for Keller's supervision. Even though such failure was not the primary basis for petitioner's liability, the charge provided him with adequate notice. It identified petitioner as president of the firm and stated that he "failed to take effective steps to prevent improper proprietary trading in the Account." Pet. App. 32a-33a. Petitioner's failure to assure that the firm had adequate procedures for supervision of Keller's activities was also addressed at the hearing. Undisputed evidence in the record showed that the firm had no management structure providing for the supervision of Keller, that petitioner was responsible for internal supervision and control and for compliance with the securities laws, and that no one at the firm supervised Keller. C.A. App. 17, 19, 23, 62, 71-72, 95, 96-97, 103-104.

4. Finally, there is no basis for petitioner's assertion (Pet. 9-11) that the decision of the court of appeals is inconsistent with the statutory requirements for Commission review of disciplinary sanctions imposed by self-regulatory organizations. The court of appeals did not confuse the Commission's role as a reviewing body with its role as a prosecuting body.[6] This proceeding involved only the Commission's statutory responsibility to review disciplinary sanctions imposed by self-regulatory organizations. See 15 U.S.C. 78s(d) and (e). In reviewing such sanctions, the Commission is required to determine whether a person's conduct violated the securities laws and rules or the self-regulatory organization's rules. 15 U.S.C. 78s(e)(1)(A). In reviewing petitioner's case, the Commission necessarily interpreted how Rule 342(a) applied to his conduct. Performance of that role does not mean that the Commission went beyond its review role and legislated a new requirement not already contained within Rule 342(a).

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[6] There was also nothing improper in the court of appeals' reliance on two decisions in which the Commission enunciated the principle that the president of a broker-dealer "is responsible for compliance with all of the requirements imposed on his firm unless and until he reasonably delegates particular functions to another person in that firm, and neither knows nor has reason to know that such person's performance is deficient." *In re Kochcapital, Inc.*, Exchange Act Release No. 31,652 (Dec. 23, 1992), 53 S.E.C. Docket 361, 370 n.18; *In re Universal Heritage Inv. Corp.*, 47 S.E.C. 839, 845 (1982). Although those cases involved Commission review of sanctions imposed by the National Association of Securities Dealers, Inc., for breach of its rule on supervisory responsibilities (not, as petitioner asserts (Pet. 10), disciplinary action by the Commission), the principle applies to Exchange Rule 342(a) as well.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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Securities and Exchange Commission

JUNE 1994

No. 93-1651

(3)

Supreme Court, U.S.
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IN THE

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OCTOBER TERM, 1993

STUART K. PATRICK,

Petitioner,

—v.—

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF FOR PETITIONER

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9pp

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The Government's brief amply demonstrates the importance of this case, and the facts that petitioner Stuart K. Patrick was denied due process and that the kind of review envisioned by Congress was not accorded to him.

1. The importance of the case

The Government now attempts to describe this case as a run-of-the-mill Exchange determination. However, Petitioner was unanimously exonerated at the Exchange hearing and found guilty only on *appeal*. Moreover, this is admittedly a case of first impression; and it admittedly sets an important precedent. Thus, the SEC itself argued to the Court of Appeals, in seeking to get the decision below published:

> "This decision is the *first* judicial decision of which we are aware that discusses and details supervisory responsibilities of officials in brokerage firms." (emphasis added)

[A 42a; see also A 43a "the decision in this case *establishes* significant judicial authority on supervisory responsibilities in securities firms . . ." (emphasis added)].

2. Petitioner's right to due process

The SEC not only failed to provide an appropriate review (as an appellate authority), but also improperly ignored the Securities Exchange Act itself. Section 6(d)(1) of the statute specifically required that the Exchange, in bringing its disciplinary proceeding, specify the conduct which was allegedly improper and the specific provision of the Exchange rules which such conduct is deemed to violate. 15 U.S.C. § 78f(d)(1).[1]

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[1] Section 6(d)(1) reads in full text:

"In any proceeding by a national securities exchange to determine whether a member or person associated with a member should be disciplined (other than a summary proceeding pursuant to paragraph (3) of this subsection), *the exchange shall bring specific charges, notify such member or person of, and give him opportu-*

The only rule which the Exchange cited in its charge against Mr. Patrick was Exchange Rule 342(a) [A 34a], and the only conduct which was specified as a violation of that rule was Mr. Patrick's alleged failure "to reasonably discharge his duties and obligations in connection with the supervision and control of the activities of" Mr. Keller, who was allegedly an employee "under his supervision" [*id.*; see also A 33a "Patrick was the direct *supervisor* of Keller and was responsible for supervision of Keller's trading in the Account"]. Those are also the only act and rule which were the subject of the hearing and which are cited in the Exchange's hearing determination. [A 28a-31a].

Mr. Patrick was unanimously exonerated of that charge at the hearing, when every witness testified that he did not have that supervisory responsibility. There was no mention in the charge of any role or supposed responsibility of Mr. Patrick as Mr. Keller's "direct *superior* [cf. Gov. Br., p. 4], and no mention of Mr. Patrick's supposed "overall supervisory responsibility for the firm's operations" [*id.*, p. 3]. Those were new charges injected into the case at the *appeal* level, which were never the subject of the hearing and are not included in the charge.[2]

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nity to defend against, such charges, and keep a record. A determination by the exchange to impose a disciplinary sanction shall be supported by a statement setting forth—

(A) any act or practice in which such member or person associated with a member has been found to have engaged, or which such member or person has been found to have omitted;

(B) the specific provision of this chapter, the rules or regulations thereunder, or the rules of the exchange which any such act or practice, or omission to act, is deemed to violate; and

(C) the sanction imposed and the reasons therefor." (emphasis added)

[2] The word "superior" also is not found in Exchange Rule 342(a) [A 38a]. In this regard, we note that the Government's quote of that rule [Gov. Br., p. 2, n.1] omits the first part of Rule 342(a), which plainly shows that it is directed at *supervision* of *activities* of employees, not the general corporate hierarchy in the firm.

The supposed role of the SEC to review the record *de novo* surely cannot mean that the SEC can (a) re-write the charge, (b) assume what Mr. Patrick would have introduced by way of evidence if he had been so charged, and (c) simply convict him on appeal without any further hearing or even confrontation of Mr. Patrick with the new charge. In so doing, the SEC took on the role of prosecutor, judge and jury, and improperly abdicated its role as reviewing appellate authority. How is an employee of a brokerage firm ever to obtain a meaningful appellate review (as Congress plainly intended) when the reviewing authority assumes the role of accuser and trial judge? Unless this court steps in to correct this abuse of power by the SEC, the decision below will become a precedent (as the SEC itself candidly told the Court of Appeals [A 43a]) for continued serious denial of due process to persons charged in disciplinary proceedings by self-regulating organizations.

3. Congress' intent

Congress established an appellate structure for review of Exchange disciplinary proceedings in order to provide the protections of due process and justice, not to deny them. Congress's intent (as codified in the Securities Exchange Act) has plainly been undermined in this case. The SEC simply ignored the statutory requirement that the Exchange set forth the specific rule and conduct at issue in its charge against Mr. Patrick. The Hearing Panel had correctly understood that, and exonerated Mr. Patrick of the only charge against him. The SEC's change (and condoning of a change) of the charge on appeal violates Congress' directive in § 6(d)(1) of the statute.

The SEC's effort to justify its decision by reference to other rules and different conduct (e.g. Mr. Patrick's supposed duties as Mr. Keller's superior in the corporate chain of command, or as a person establishing the supervisory procedures of the firm under Exchange Rule 342(b), etc.) is the opposite of what Congress had in mind when it designated the SEC as the

reviewing appellate authority. The SEC is supposed to wear its appellate review hat in this situation, not its enforcement prosecutorial hat, as occurred here.

The Government (like the SEC) now contends that the conduct which supposedly gave rise to Mr. Patrick's guilt is his supposed "failure to establish appropriate procedures for supervision" [Gov. Br., p. 7]). There is no such language in Exchange Rule 342(a) [cf. A 38a]. The SEC's contention that such a duty is part of Rule 342(a) seeks to re-write that rule by engrafting onto it matters expressly provided in Rule 342(b). In so doing, the SEC took on a *legislative* role, at odds with its role as appellate reviewing authority. The very fact that such a duty is expressly provided in Rule 342(b) would lead any reasonable person to believe that, if one is to be charged with such a violation, the charge will be brought under and cite Rule 342(b) — as required by § 6(d)(1) of the statute. Here, Mr. Patrick was not given such notice and opportunity to defend, resulting in a serious denial of due process to him.

The Government's contention that "exchange hearing panel decisions often describe Rule 342(a) decisions in terms of the duties under Rule 342(b)" [Gov. Br., p. 7, n.4] is simply wrong. As detailed in the Courts below, Exchange hearing panel decisions do not do so, but rather show that, where violations of both Rules 342(a) and Rule 342(b) are charged, both rules are expressly cited and the specific conduct involved is expressly delineated.[3] Moreover, the governing

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[3] The Government's brief is filled with other serious factual errors and statements which are inconsistent with the record and the evidence before the Hearing Panel. For example, the Government contends that Mr. Patrick was not charged solely as Mr. Keller's designated supervisor, but rather also as his "direct corporate superior" [Gov. Br., p. 7]; a review of the Charge [A 32a-34a] shows that there was no such allegation against Mr. Patrick. Nor was there any reference to Mr. Patrick's supposedly being liable based upon "the corporate chain of command" [*id.*]. Similarly, the Government is simply wrong in contending that, even though the Charge did not advise Mr. Patrick that he might be held liable

authority in this regard is § 6(d)(1) of the Securities Exchange Act (and, of course, the Constitution), not what one exchange hearing panel may have said in one uncontested consent settlement (i.e., the one case cited by the Government for this statement).

Congress also set forth a detailed rule-making procedure in the Securities Exchange Act, whereby proposed Exchange rules are published, subject to comment and thereafter reviewed by the SEC (in a different capacity from that of the SEC as appellate reviewing authority). The language of Rule 342(a) and Rule 342(b) is clear; the two rules, on their face, address different kinds of conduct. It was not the province of the SEC, when acting as appellate reviewing authority of the disciplinary proceeding against Mr. Patrick, to decide to meld those two rules together and decree that they are interchangeable, despite their plainly different language. In doing so, the SEC once again confused its roles and failed to provide Mr. Patrick the meaningful appellate review which Congress promised him.

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for supposedly failing to establish supervisory procedures, that matter was "addressed at the hearing" [Gov. Br., p. 8, n.5]. That was not the subject of the hearing. The only evidence presented by the Exchange on that subject was a brief reference during *Respondent's* case (i.e. after the Exchange had rested) to Mr. Patrick's role and duties as President of the firm; that hardly provides "adequate notice" that, even though the Charge never mentioned the words "direct superior", Mr. Patrick might be held guilty on appeal based upon his superior corporate position. Even assuming that the SEC may have a right to make its own findings, such findings must be based upon the evidence in the record, not the whim of the SEC or the unsubstantiated contentions of the Exchange.

Conclusion

The petition for a writ of certiorari should be granted.

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Respectfully submitted,

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